

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

COAST FEDERAL SAVINGS AND LOAN ASSOCIATION OF
LOS ANGELES, a corporation,

Appellant,

vs.

R. M. CRAWFORD, Trustee in Bankruptcy of the Estates
of Maxfield-Wilton & Associates, Inc., a corporation,
debtor, Residential Income Properties, Inc., a corpora-
tion, subsidiary debtor, and Wilton-Maxfield Manage-
ment Company, a corporation, subsidiary debtor; MAX-
FIELD-WILTON & ASSOCIATES, INC., RESIDENTIAL IN-
COME PROPERTIES, AND WILTON-MAXFIELD MANAGE-
MENT COMPANY, and SECURITIES AND EXCHANGE
COMMISSION,

Appellees.

APPELLEES' BRIEF.

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vs.

R. M. CRAWFORD, Trustee in Bankruptcy of the Estates of Maxfield-Wilton & Associates, Inc., a corporation, debtor, Residential Income Properties, Inc., a corporation, subsidiary debtor, and Wilton-Maxfield Management Company, a corporation, subsidiary debtor; MAXFIELD-WILTON & ASSOCIATES, INC., RESIDENTIAL INCOME PROPERTIES, AND WILTON-MAXFIELD MANAGEMENT COMPANY, and SECURITIES AND EXCHANGE COMMISSION,

Appellees.

APPELLEES' BRIEF.

Statement of the Case.

Appellees do not controvert the statement of the case as presented by the appellant excepting the statement that the subsidiary debtor arranged through a "dummy" to purchase a parcel of real estate from the appellant. Rather it negotiated directly with the appellant for the purchase of said real estate, and, for reasons of its own, had the legal title to the property placed in the name of Joseph Honey who the Referee and the United States District Court found to be a "dummy" purchaser.

ARGUMENT.

The appellant has set forth at page 5 of its brief six specifications of error, but it has failed in its argument to support its contentions concerning the first five specifications of error by any citations of authority, nor has it in any other manner assisted the court in making a decision concerning these specifications of error. The argument of the appellant has been directed solely to specification of error No. 6, to wit: that the court erred in disallowing the appellant's claim. For this reason appellees are assuming that the appellant is not seriously contending that the court erred in the respects set forth in specifications of error one to five, and appellees will restrict their argument in answering the argument set forth in appellant's opening brief.

The first point raised by the appellant in its argument is that the appellees are bound by the guarantee contract made by the subsidiary debtor in spite of the evidence which was introduced at the time of the trial before the Referee, and in spite of the findings which were made by the Referee after the hearing of the Trustee's objections to the appellant's claim, which said findings and order were confirmed and approved after petition for review by the United States District Court, Wm. P. James presiding.

The evidence, which consisted principally of certain exhibits which were introduced at the hearing before the Referee and which are included in the agreed statement of facts before this Court, shows that the correspondence concerning the purchase of the property in question was carried on between the appellant and Mr. Hugh Wilton, president of the subsidiary debtor, and after the consummation of the sale, the payments on the purchase

money note and deed of trust, which were given for the balance of the purchase price of said property, were made by the subsidiary debtor and not by Joseph Honey who was the "dummy" buyer to whom the subsidiary debtor requested the appellant to transfer the legal title.

The Referee in his opinion, which is included in the agreed statement before this Court, stated, after considering the evidence:

"The evidence clearly shows that Honey had no real interest in the property and that he took title thereto only as a 'dummy' for the subsidiary debtor and that this was known to the Coast Federal Savings and Loan Association at the time the deal was made."

It is apparent that the Referee and the United States District Court in rendering the decisions in this case have looked through the form of the papers, which were executed by the respective parties in the transaction, in an effort to ascertain the true substance and effect of the transaction, as well as the intention of the parties in entering into it.

Trustee's Exhibit No. 1, which is included in the agreed statement, is a letter from the appellant addressed to Mr. Hugh Wilton, who was at that time the president of the subsidiary debtor corporation, dated July 31st, 1937. The Court will note that that letter states, among other things, the following:

"We hereby confirm our sale and *your purchase* of the property located at 2218 South Hobart, Los Angeles." (Italics ours.)

This letter was signed by J. E. Holoday, assistant to the president of the appellant.

It is obvious from the language of this letter that the appellant in making the sale was dealing with the president of the subsidiary corporation, and not with Mr. Honey, the “dummy” purchaser, and that it knew at all times that the subsidiary debtor was the real purchaser of the property and that Joseph Honey was to hold the legal title for the benefit of the real purchaser, to wit: the subsidiary debtor.

It is the primary contention of the appellees that since the subsidiary debtor was the real purchaser of the property it is to be protected by the provisions of Section 580b of the Code of Civil Procedure, which said Code section was in effect in the State of California at the time the transaction was entered into.

The appellant makes no contention that the note secured by deed of trust on said real property was not a purchase money note and deed of trust, and if this Court recognizes, as the Referee and the United States District Court did, that the subsidiary debtor was the real purchaser, then it logically follows that the subsidiary debtor is entitled to the protection of the provisions of Section 580b of the Code of Civil Procedure, and that the appellant is not entitled to a deficiency judgment.

Section 580b of the Code of Civil Procedure of the State of California reads as follows:

“No deficiency judgment shall lie *in any event* after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to secure payment of the balance of the purchase price of real property.” (Italics ours.)

As the Referee stated at page 3 in his opinion following the hearing of the Trustee's objections to the appellant's claim:

“Clearly this section absolutely prohibits a deficiency judgment *against a purchaser* under a deed of trust given to secure the payment of the balance of the purchase price of a parcel of real property. In my opinion the subsidiary debtor in this case was in reality and in fact the purchaser in the transaction which is here under consideration, and for this reason alone I feel that the claim here asserted must be disallowed.”

The reason for the enactment of Section 580b of the Code of Civil Procedure was recognized by the Referee and we feel it should be recognized by this Court. This section was enacted at a time when there was practically no market for distressed real estate, and the situation arose frequently in which one who had sold real property and had taken a note and deed of trust as security for the balance of the purchase price foreclosed and because there were no substantial bidders at the sale the holder of the deed of trust bid in the property at his own price thereby enabling him—

1. To retain everything that had been paid on the purchase price;
2. To recover the identical property which he had sold; and,
3. To still have a cause of action for a substantial portion of the original purchase price.

The legislature of California apparently recognized that this permitted the seller to unjustly enrich himself at the expense of those with whom he had dealt in the sale of

the property. It was to remedy this situation that the legislature provided that “no deficiency judgment shall lie *in any event*” on a purchase money trust deed.

This brings us to the second contention of the appellee, to wit: that even though the Court refuses to recognize that the subsidiary debtor was the real purchaser and therefore entitled to the protection of the provisions of Section 580b of the Code of Civil Procedure, nevertheless the subsidiary debtor even as guarantor is entitled to the protection of said Code section.

The appellant contends that it is not seeking to recover a deficiency judgment in this case but instead is seeking to recover a balance due upon the obligation of the guarantor. It is submitted that the appellant here is attempting to make a distinction without a difference since a deficiency has been defined to be:

“A lack, shortage, or insufficiency. The difference between the total amount of the debt or payment meant to be secured by a mortgage and that realized on foreclosure and sale when less than the total. A judgment or decree for the amount of such deficiency is called a ‘deficiency judgment’ or ‘decree.’”

Black’s Law Dictionary, 2nd Ed., page 345.

It is obvious that whatever the appellant desires to call his claim it is for the difference between the total amount of the debt or payment meant to be secured by the deed of trust and that realized on foreclosure sale when less than the total obligation. Therefore, the appellant is actually seeking to recover a deficiency judgment against the guarantor for the balance remaining due on the obligation after the sale of the property which was given as security for the purchase price.

This is expressly prohibited by the terms and provisions of Section 580b of the Code of Civil Procedure.

In the case of *Central Trust Company v. Manly*, 100 Fed. (2d) 992, Circuit Court of Appeals, Fifth Circuit, January 20, 1939, an action was brought by a purchase money mortgagee against certain endorsers upon a purchase money note secured by mortgage. The transaction was controlled by the Florida statute enacted in 1927 concerning deficiency judgments. The Court held that the purchase money mortgagee was not entitled to recover against the endorsers, and stated at page 994:

“But the deficiency decree has finally and fully fixed the balance owing by the mortgagor, the maker of the notes, and these indorsers who are really sureties can owe no more. Their obligation as held in the case of *Scott v. National City Bank of Tampa, supra*, is not upon any separate contract of indorsement, but as respects the creditor is a liability with the maker upon the notes themselves, and as respects the maker they are sureties entitled to reimbursement from the maker for all they are forced to pay. They as sureties are entitled to use as a defense a favorable judgment as to the amount of the debt which the maker has won against the creditor, just as they would be to use any other defense not purely personal which the maker might have.”

Thus it may be seen that the Circuit Court of Appeals applied the Florida statute for the protection of an endorser upon a purchase money note, as well as for the protection of the original maker of said note. It would logically follow that the so-called guarantor upon the purchase money note in question would be entitled to the same protection in the instant case.

In the case of *Honeyman v. Hanan*, 275 New York 382, an action was brought by a mortgagee for a deficiency against the obligor of a bond which was given as security for a note and mortgage. It was contended by the defendant in this case that the plaintiff could not recover against him because of the provisions of Sections 1083a and 1083b of the Civil Practice Act of New York governing the recovery of deficiency judgments. The Court held that the bond in question created an indirect obligation to pay the amount remaining unpaid upon the original bond secured by the mortgage on real property and that Sections 1083a and 1083b of the Civil Practice Act applied to the action against the bond given by the defendant as security. Section 1083a of the Civil Practice Act of New York provided, among other things, that if no motion for a deficiency judgment was made, as prescribed by said section, the proceeds of the sale, regardless of the amount, should be deemed to be in full satisfaction of the mortgage deed and no right to recover any deficiency in any action or proceeding shall exist.

In the *Honeyman* case, *supra*, a deficiency judgment was denied in the foreclosure action upon a motion made pursuant to Section 1083a of the Civil Practice Act, and the New York court held that under the circumstances Section 1083a governing actions for deficiency prohibited the mortgagee from recovering upon the additional bond given as security for the principal obligation. It would thus appear that this case is a complete answer to the appellant's contention in the instant case that the provisions of Section 580b of the Code of Civil Procedure do not apply to their claim against the guarantor, the appellee herein. The New York court found in effect that the mortgagee was seeking to obtain a deficiency

judgment against an obligor whose obligation was similar to that of the guarantor in the instant case.

The appellant relies principally on two California cases, to wit: the case of *Loeb v. Christie*, 6 Cal. (2d) 416, and *Bank of America v. Hunter*, 8 Cal. (2d) 592. It is submitted that the Referee correctly found that these cases were not controlling in the instant case and were distinguishable for several reasons. In the case of *Loeb v. Christie*, *supra*, the Supreme Court affirmed a judgment against the guarantor of a trust deed note notwithstanding the fact that the trust deed had not been foreclosed. It was contended in that case that an action will not lie against a guarantor of a secured obligation until the security has been exhausted. Of course the decision on this question has no bearing upon the instant case for the reason that the security has already been exhausted and the holder of the trust deed obligation is now seeking to collect the deficiency or balance due after the sale of the property. The Court held in the *Loeb* case, *supra*, that it was not necessary to exhaust the security before bringing the action against the guarantor. The Court also found in that case that Section 2809 of the Civil Code did not require a different result for the reason that the Court's conclusion did not cause the guarantor's obligations to be any heavier or more burdensome than that of the principal or maker of the note and stated at page 419:

“ ‘The obligation of a guarantor must be neither larger in amount nor in other respects more burdensome than that of the principal; and if in its terms it exceeds it, it is reducible in proportion to the principal obligation.’ * * * Our conclusion does not cause the guarantor's obligations to be any heavier or more burdensome than that of the principal or maker of the note.”

And the Court stated at page 420:

“The principal debtor remains liable at all times for the full amount of the obligation and may be compelled to pay it, first out of the security, and thereafter out of his general assets. The obligation of the guarantor is no heavier or more burdensome, since he is liable for as much as, but no more than, the principal debtor or maker of the note, viz: the face value of the note.” (Italics ours.)

Of course it is obvious that in the instant case the principal debtor does not remain liable at all times for the full amount of the obligation, nor may he be compelled to pay it, since the principal debtor on a purchase money note and mortgage is protected by Section 580b of the Code of Civil Procedure.

Section 2809 of the Civil Code provided at the time the transaction in question was entered into, as follows:

“The obligation of a guarantor cannot exceed that of the principal. The obligation of a guarantor must be neither larger in amount nor in other respects more burdensome than that of the principal; and if in its terms it exceeds it, it is reducible in proportion to the principal obligation.”

The question in the *Loeb* case, *supra*, involved solely the matter of the remedy and the court held that even though the mortgagee was entitled to pursue a different remedy against the guarantor than against the maker of the note, the guarantor's obligation was not thereby caused to be any more burdensome than that of the principal obligor. However, in the instant case we are faced with a completely different situation and one involving the question of substantive law rather than a question of

remedy. This is apparent from the fact that the principal obligor on the purchase note and mortgage is no longer liable for any sum or amount over and above the market value of the real property which was received at the time of the sale of the property after foreclosure or under power of sale under a deed of trust, and obviously if the guarantor were to be held responsible for the full amount of the note and mortgage, or for a deficiency after sale, even though the principal obligor of the purchase note and mortgage were not, the guarantor's obligation would be heavier and more burdensome than that of the principal or maker of the note. That this is a question of substantive law rather than remedial law is shown by the case of *McGill v. Brewer*, 285 Pac. 208 (Oregon). In the State of Oregon there is a statute similar to the California statute prohibiting deficiency judgments in the case of purchase money mortgages, and in the *McGill* case, *supra*, an action was brought in the State of Oregon on a note and mortgage pertaining to real property in the State of Montana. The question arose as to whether or not the mortgagee was entitled to a deficiency judgment in an action brought in the State of Oregon. The Court held that plaintiff was entitled to a deficiency judgment for the reason that it was permitted under the laws of the State of Montana which permitted deficiency judgments. It is fundamental rule of law that the remedy to be afforded the plaintiff is governed by the law of the state in which the action is brought, but that if it is a question of substantive law it is governed by the law of the state where the real property is situated if the action is one concerning a mortgage on real property.

It follows from the decision in this case that the Supreme Court of Oregon found that the statutes regulat-

ing the recovery of deficiency judgments on purchase money mortgages were statutes governing substantive law rather than the remedy to be accorded the mortgagee.

It is submitted that this case justifies and supports the conclusion of the Referee and of the United States District Judge that to hold the guarantor liable in the instant case would cause its obligation to be more burdensome than that of the principal, contrary to the provisions of Section 2809 of the Civil Code.

The case of *Bank of America v. Hunter*, 8 Cal. (2d) 592, upon which appellant also relies to support its position, is also distinguishable from the instant case for the following reasons: The agreement of guarantee in that case was a continuing guarantee limited in amount but general in its nature in that it covered all advances made to the principal within the limits of the guaranty. As the Referee pointed out in his opinion it was not a specific guarantee of a trust deed note such as we have in the instant case. The *Bank of America* case is further distinguishable upon the ground that the provisions of Section 580b of the Code of Civil Procedure were not mentioned nor considered by the Supreme Court in its decision for the reason that the trust deed involved in that case was not a purchase money trust deed.

As a matter of equity and justice the mortgagee or holder of the deed of trust in the instant case is not entitled to recover a deficiency judgment against the so-called guarantor for the reason that it has received through the sale of the property covered by the deed of

trust the property which the Referee found to be of the value of \$7250.00 at the time of the sale. The original purchase price of the property on August 11th, 1937, was only \$7000.00, and at the time of the foreclosure on July 15, 1939, the unpaid principal balance was \$5754.33. It would therefore appear that by the foreclosure of the property the original purchase price was fully satisfied and that the vendor should not now be permitted to be unjustly enriched to the detriment of the appellee.

In conclusion it is respectfully submitted that the orders appealed from should be affirmed for the reasons stated herein, to wit:

1. That the subsidiary debtor, or so-called guarantor, was the actual purchaser of the real property in question and therefore clearly is entitled to the benefits of Section 580b of the Code of Civil Procedure;

2. That even though the so-called guarantor is not the actual purchaser he is entitled to the protection and benefits of Section 580b, for a recovery against the guarantor would permit the holder of a purchase money trust deed to do indirectly what Section 580b of the Code of Civil Procedure prevents him from doing directly;

3. The holder of the purchase money trust deed should not be permitted to recover against the appellee for a deficiency for the reason that such recovery would be contrary to the provisions of Section 2809 of the Civil Code providing that the obligation of a guarantor cannot be heavier or more burdensome than that of the principal; and,

4. Justice and equity should prohibit the appellant from recovering against the guarantor, for such recovery would permit an unjust enrichment to the appellant at the expense of appellee and thereby deny the guarantor the equal protection of the laws, by reason of the fact that guarantors and sureties on other obligations are not so deprived of their right of reimbursement from the principal debtor.

Respectfully submitted,

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